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Ratings

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Research Update:

Investment Holding Company Georgia Capital Affirmed At 'B'; Outlook Stable

June 29, 2020

Rating Action Overview

- Earlier in May, Georgia Capital (GC) launched a tender offer to acquire the remaining 29% of Georgia Healthcare Group (GHG) through an equity swap, with the intention of delisting GHG.
- Although this transaction will increase the share of unlisted assets in GC's portfolio to about 80%, we believe it will slightly reduce leverage and provide GC with room to better adjust the portfolio in the medium term.
- Our adjusted loan-to-value (LTV) ratio for GC, including the equity swap and a haircut on unlisted investee companies' value to reflect the impact of the COVID-19 pandemic, declined to 37% from more than 40% in March 2020 but is still much higher than 25% in July 2019.
- We are therefore affirming our 'B' rating on Georgia Capital.
- The stable outlook reflects our view that Georgia Capital's liquidity will remain adequate, its LTV ratio below 45%, and the cash flow adequacy ratio higher than 0.7x for 2020 before slightly improving in 2021.

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Rating Action Rationale

We expect GC's proposed full acquisition of GHG to be neutral for the rating. GC proposes to buy out the holders of GHG's remaining shares in exchange for shares in GC, in a transaction motivated by low liquidity of the currently listed GHG shares. After the transaction closes, which we expect to occur at the end of July 2020, GHG is expected to be delisted. With that, the share of listed assets in GC's portfolio will reduce to about 20%, which is in line with the company's policy to retain about 80% of its portfolio in unlisted assets. Although we foresee asset liquidity reducing, we consider positive that the transaction will solidify GC's control over GHG. It will also provide GC with better opportunities to find a strategic buyer for this asset and support GC's dividend stream. The equity swap also slightly increases GC's portfolio value and marginally improves its LTV ratio. We therefore see the proposed transaction as broadly neutral for our rating on GC.

GC's current LTV ratio of about 37% remains consistent with the current rating albeit indicating limited ability to deleverage. The current economic downturn caused by the COVID-19 pandemic has hurt global equity markets, which remain weak and volatile despite showing some recovery from the low observed in March 2020. Since then, the Georgian lari (GEL) has gained ground against the U.S. dollar, with the current exchange rate at GEL3 to $1 versus GEL3.3 to $1 on March 31, 2020. This, together with the impact of the equity-funded minority buyout of GHG results in GC's LTV reaching 37% compared with more than 40% in March, although still much higher than the 25% recorded in July 2019. The company is actively involved in evaluating potential exits, which could support deleveraging over the next two years. However, given the current market conditions, we believe there won't be any disposals this year. In assessing the value of the company's unlisted assets, we applied a 10% haircut to values reported in March 2020, since they already factored in some COVID-19-related devaluation. We note that, despite the spike in LTV, the company still has some headroom under the 45% threshold for the current rating.

The portfolio includes a high share of defensive assets, which should provide resilience from the impact of COVID-19. The travel and hospitality sectors are among the most affected by COVID-19, since the pandemic has brought international travel and tourism to a halt. However, these sectors represent only a small share of GC's asset portfolio, namely less than 10% of our adjusted portfolio value. In addition, more than 50% of the portfolio consists of stakes in water utility, property/casualty insurance, and renewable energy businesses, as well as GHG, which in our view are less susceptible to volatility risks. That said, for 2020, we foresee GC's dividend income reducing to only GEL30 million in 2020 from a net dividend of GEL70 million in 2019. This leads to a decline in our cash adequacy ratio to 0.8x from more than 1.5x in 2019.

The portfolio's small size, foreign currency exposure, weak weighted average credit quality, and high concentration of assets are rating constraints. The weighted average creditworthiness of investee companies is in the 'B' rating category. GC's portfolio is valued at about $700 million, which is smaller than that of many other investment holding companies we rate globally. Also, there is some concentration since the three largest assets form 62% of the total portfolio. All of GC's debt is denominated in U.S. dollars, while most of its portfolio companies are focused on the domestic market and derive revenues in Georgian lari. The above factors alongside GC's sole concentration in the Georgian economy constrain our assessment of the company's business risk.

Outlook

The stable outlook reflects our view that GC's LTV ratio will remain below 45% in the next 12 months, due to management's proactive measures to maintain leverage commensurate with the current rating. We also expect GC to maintain its liquidity buffers and refrain from lending and making capital contributions to investee companies until dividend inflow increases to previous levels and cash flow adequacy ratio recovers to more than 1x.

Downside scenario

We could lower the rating if there are any signs that GC's liquidity is deteriorating, for example if cash balances decrease and dividend and interest cash inflows remain insufficient to cover operating and interest cash outflows. This could also happen if the lari depreciates substantially against the U.S. dollar, squeezing GC's available cash sources to pay interest. We could also lower the rating if GC's LTV remains above 45% or the cash flow adequacy ratio declines to less than

0.7x and the company does not take immediate action to restore its credit metrics. Rating pressure could also result from a material deterioration of the credit quality of any of GC's core investments, which would erode valuations and increase the likelihood of GC having to inject fresh capital for support.

Upside scenario

We could raise the ratings if GC's portfolio characteristics--such as liquidity, asset quality, and portfolio diversification--materially improve. In addition, portfolio valuation increases or use of potential exit proceeds for deleveraging, resulting in LTV ratios staying well below 30%, and management's strong commitment to a more stringent financial policy could prompt a positive rating action. An upgrade would depend on liquidity remaining adequate.

Company Description

GC is an investment holding company based in Georgia. Its parent Georgia Capital PLC is listed on the London Stock Exchange and as of June 25, 2020, had a market value of £171 million. Pro form the buyout of the remaining GHG minority stake and delisting of GHG, about 19% of GC's portfolio will consist of listed shares and the remainder unlisted equity participations in investee companies in Georgia, in banking, pharmaceuticals, health care, utilities, real estate, hospitality, private education, insurance, beverages, auto services, and renewable energy generation. Its key investments include 19.9% of U.K.-listed Bank of Georgia; 70.6% of U.K.-listed Georgia Healthcare Group (we assume ownership increases to 100% followed by delisting); 100% of Georgian Global Utilities, a water utility business; 100% of M2, a real estate and hospitality business; 100% of Georgian Renewable Power Company; 100% of Aldagi, a property and casualty insurance company; 100% of Greenway, a periodic technical inspection business; majority stakes of 70%-90% in three leading private schools; and an 87% stake in Georgia Beverages.

Our Base-Case Scenario

Assumptions

- Decline of real GDP in Georgia of 4.0% in 2020, followed by real GDP growth of 4% in 2021.
- Georgian lari exchange rate of GEL3 per $1 in 2020 and GEL3.07 in 2021.
- Interest income of GEL20 million-GEL25 million annually.
- Dividend income of GEL30million-GEL40 million annually.
- Operating expenses at the holding company of about GEL20 million and interest expenses of GEL54 million per year.
- No further material debt incurred at GC.
- No dividends in 2020-2021.
- No capital contribution or additional loans to investee companies in 2020.

Key metrics

Based on these assumptions, we arrive at the following credit measures:

- An LTV ratio below 40% from less than 25% in July 2019.
- Cash flow adequacy ratio declining to 0.8x in 2020 from more than 1.5x in 2019 and slightly improving in 2021.

Liquidity

We assess GC's liquidity as adequate. We estimate that its sources of liquidity cover sources by about 3x as of March 31, 2020. We do not assess the company's liquidity as strong because we believe it won't be able to absorb significant external shocks without additional financing. We believe GC has sound relationships with local banks, given its important position as a key investor in the country.

We understand the company has decided to postpone capital contributions and lending to investee companies to preserve liquidity in the current environment and in view of reduced dividend inflow. Nevertheless, its ability to refinance debt could be restricted, since the domestic capital markets are relatively shallow and GC has no committed back-up facilities. That said, the company has a smooth debt maturity profile, with a bullet maturity in 2024 when its bond is due. We understand that management has committed to keep at least $50 million of cash and equivalents in foreign currency and that the company has no near-term debt maturities.

Principal liquidity sources

We estimate principal liquidity sources over the 12 months from March 31, 2020, include:

- Cash and cash equivalents (mostly sovereign and Georgian corporate bonds) of GEL170 million; and
- Dividends from portfolio companies and interest income of about GEL48 million after a 15% haircut to our estimate of dividend and interest inflow of more than GEL55 million.

Principal liquidity uses

We estimate that principal liquidity uses over the same period comprise:

- Operating costs of around GEL19 million;
- Interest expenses of approximately GEL54 million; and
- No dividends to shareholders or share buybacks.

Covenants

The bond documentation contains only an incurrence ratio of net debt to adjusted equity value of below 45% and we believe the headroom is tightening. However we believe the company is putting adequate measures in place to restore it.

Issue Ratings--Subordination Risk Analysis

Capital structure

GC's capital structure includes the $300 million unsecured bond.

Analytical conclusions

We rate the notes in line with our issuer credit rating on GC, because no elements of subordination risk are present in the capital structure.

Ratings Score Snapshot

Issuer Credit Rating: B/Stable/--

Business risk: Vulnerable

- Country risk: High
- Industry risk: Intermediate
- Investment position: Vulnerable

Financial risk: Aggressive

- Cash flow/Leverage: Significant
- Funding and capital structure: Negative

Anchor: b

Modifiers

- Liquidity: Adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: b

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | Industrials: Methodology: Investment Holding Companies, Dec. 1, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014

- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Investment Holding Company Georgia Capital Downgraded To 'B' On Increased Leverage Ratio Due To COVID-19; Outlook Stable, April 3, 2020

Ratings List

Ratings Affirmed	
JSC Georgia Capital	
Issuer Credit Rating	B/Stable/--
Senior Unsecured	B

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.